F I S C A L   I M P A C T   R E P O R T

SPONSOR Figueroa/Madrid/ Allison/Martinez, J **ORIGINAL DATE** 2/13/19 **LAST UPDATED** 2/19/19 **HB** 23

SHORT TITLE Increase Working Families Tax Credit **SB** Graeser

ANALYST

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
	($53,000)	($55,000)	($56,000)	($58,000)	Recurring	General Fund (PIT)

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY19	FY20	FY21	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total		$0.0	$0.0	$0.0	Recurring	TRD Operating

Parenthesis ( ) indicate expenditure decreases

SOURCES OF INFORMATION
LFC Files

SUMMARY

Synopsis of Bill

House Bill 23 increases the Working Families tax credit (WFTC) from 10 percent of the corresponding federal earned income tax credit (EITC) to 20 percent of federal EITC.

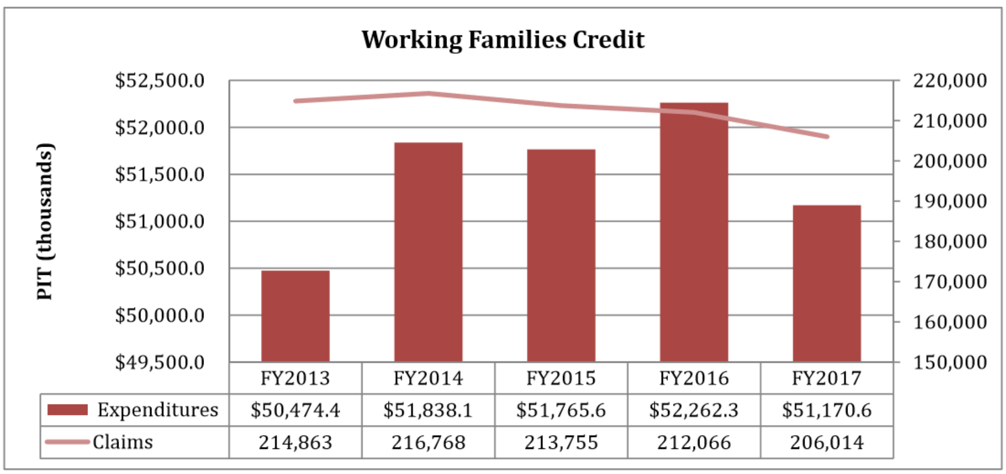
There is no effective date of this bill. It is assumed that the effective date is 90 days after this session ends (June 14, 2019). The provisions are applicable to taxable years beginning January 1, 2019. This credit is not available for state purposes in weekly paychecks, so the full impact will be as refunds claimed January through June 2020, in FY 20.

FISCAL IMPLICATIONS

TRD and LFC have separately estimated the fiscal impact of this bill. The estimate in the table is that of TRD and is consistent with the impact reported in HB6.

Methodology for Estimated Revenue Impact: The Taxation and Revenue Department (TRD) reviewed the working family tax credit (WFTC) claims for the last five years and calculated the current 5-year average based on the 10 percent credit. The bill increases the percentage to 20 percent, thereby doubling the size of the credit that may be claimed. The annual revenue impacts are increased based on the personal income tax growth rates in the December 2018 Consensus Revenue Estimating Group (CREG) estimate. The federal earned income tax credit (EITC) is annually adjusted based on the chained-consumer price index for urban consumers (C-CPI-U.) The CREG growth rates are a proxy for the federal indexing.

LFC used a somewhat different methodology resulting in similar initial fiscal impacts, but substantially slower growth rates. The methodology did a linear projection of claims and average amount of claim, based on the five-year history exhibited in the 2017 TRD Tax Expenditure Report.



Source: 2017 TRD Tax Expenditure Report

	TY12	TY13	TY14	TY15	TY16					
	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22
WFTC $ (1,000s)	$50,474	$51,838	$51,766	$52,262	$51,171	$52,047	$52,229	$52,411	$52,592	$52,774
WFTC Claims	214,863	216,768	213,755	212,066	206,014	205,973	203,733	201,493	199,253	197,013
Avg Claim	$235	$239	$242	$246	$248	$253	$256	$260	$264	$268
EITC$ (Millions)	$511,475	$528,239	$529,254	$537,800	$527,226	$539,118	$543,224	$547,330	$551,437	$555,543
EITC Claims	222,270	223,560	220,440	220,320	215,650	215,504	213,856	212,208	210,560	208,912
Avg Claim	$2,301	$2,362	$2,400	$2,440	$2,444	$2,501	$2,540	$2,579	$2,618	$2,659
Ratio $	98.7%	98.1%	97.8%	97.2%	97.1%	96.5%	96.1%	95.8%	95.4%	95.0%
Ratio Claims	96.7%	97.0%	97.0%	96.3%	95.5%	95.6%	95.3%	95.0%	94.6%	94.3%

EITC source: Internal Revenue Service/Statistics of Income Division (IRS/SOI)

The WFTC expenditures and claims are shown in the graphic above and in the table. The corresponding EITC expenditures and claims are shown in the table. The projections are simple linear trends. Note that the WFTC extrapolates to a slightly increasing total expenditures and some less claims. On the other hand, the EITC extrapolates to increasing expenditures and decreasing claims. The increase would occur in the second half of FY20. For the purpose of the Revenue Table on page 1, the projection of WFTG is used.

Estimated Revenue					**Recurring or Nonrecurring**	**Fund Affected**
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
	($52,400)	($52,600)	($52,800)	($53,000)	Recurring	General Fund (PIT)

This bill may be counter to the LFC tax policy principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

SIGNIFICANT ISSUES

The apparent purpose of this bill is to return money to certain low- to moderate income working family taxpayers to make up for an estimated $55 million increase in state personal income taxes caused because the state did not adjust to the federal Tax Change and Jobs Act of 2016 (TCJA).

However, the increases are across the board, with the largest increases being for higher income taxpayers that have had some of their itemized deductions reduced and taxpayers with a large number of dependents since the TCJA repealed personal exemptions in favor of a substantial increase in the standard deduction and an increase in the child credit. New Mexico "piggybacks" on the repeal of the personal exemptions, the increase in standard deduction and the disallowance or limitation of itemized deductions. However, it does not piggyback on the federal child credit.

TRD has provided the following discussion of policy issues:

> It is estimated that doubling this refundable tax credit will be an average of $250 into the budgets of roughly 210,000 New Mexico families. The size of the federal EITC, and therefore New Mexico's WFTC, are phased out as a family's income rises. This phased approach offsets the tax cliff that can occur when a family member enters the labor force.
>
> The federal EITC was started in 1975. The New Mexico WFTC was enacted in 2007 and amended once in 2008. New Mexico is among 27 states, the District of Columbia and New York City that offers a similar version of the WFTC.[1] While the WFTC is a tax expenditure for the state and will increase under this bill, because of its broad citizen benefit and ease in administering, it can be seen as one of many efficient policy tools to assist low and middle income individuals and families.
>
> There are benefits to both those receiving the credit and all citizens in general. The credit is seen as encouraging employment, for to be eligible, individuals must have earned

[1] "Iowa's Earned Income Tax Credit, Tax Credit Program Evaluation Study", December 2016, Iowa Department of Revenue

income. Secondly, this credit can help to counter the regressivity of other taxes such as payroll taxes, gross receipts tax, and gasoline tax. Regressive, in this context, meaning taxes that consume proportionally more of the income of the poor than of the wealthy. While it is difficult to measure the level of benefit from the credit, the credit has been a stable and consistent resource for low and middle income individuals and families.

To be eligible for the EITC and WFTC, an individual must file a New Mexico Personal Income Tax Return, must have a social security number, must not have investment income over $3,500, and must meet requirements for adjusted gross income, as shown below:

	Qualifying Children Claimed			
Filing Status	**Zero**	**One**	**Two**	**Three or more**
Single, Head of Household or Surviving Spouse	$ 15,270	$ 40,320	$ 45,802	$ 49,194
Married Filing Jointly	$ 20,950	$ 46,010	$ 54,492	$ 54,884
Max Federal EITC Credits:	$ 519	$ 3,461	$ 5,716	$ 6,431
Max State WFTC Credits (20% of EITC)	$ 104	$ 692	$ 1,143	$ 1,286

PERFORMANCE IMPLICATIONS

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose. For the past four years, TRD has prepared a Tax Expenditure Report, which is available to the public and to legislative committees.

ADMINISTRATIVE IMPLICATIONS

This change can be accomplished in TRD's regular maintenance cycle.

TECHNICAL ISSUES

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

OTHER SUBSTANTIVE ISSUES

The ratio between expenditures and claims between the State WFT and the federal EITC are similar and are in the range of 97 percent to 99 percent for expenditures and 95 percent to 97 percent for claims. This could be explained by the requirement that a taxpayer must be present in the state for six months of the year to qualify to the WFTC. First year residents might not qualify for WFTC, but would qualify for EITC. Emigrants from the state would not file from a New Mexico address and would not be included in the IRS/SOI data.

ALTERNATIVES

If the intent is to make the taxpayers who are experiencing their share of the $55 million increase in state taxes because of the changes in TCJA, then some thought should be given to creating a child credit along the lines of HB-18.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

LG/al/gb